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In the Supreme Court of the United States

October Term, 1939

[redacted]

vs.

[redacted]

PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF [redacted]

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In the Supreme Court of the United States

OCTOBER TERM, 1939

No. —

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

S. C. THOMSON

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

The Solicitor General, on behalf of Guy T. Helvering, Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the decision of the United States Circuit Court of Appeals for the Second Circuit entered in the above-entitled cause on January 25, 1940.

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 10–15) is reported at 40 B. T. A. 60. The opinion of the Circuit Court of Appeals (R. 72) is reported in 108 F. (2d) 642.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered January 25, 1940 (R. 74). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The taxpayer held certain debentures of a corporation which went into receivership. Pursuant to a court order approving a plan of reorganization of the debtor the taxpayer surrendered his debentures and received a small part of their face value in full payment and settlement. The question is:

Whether such discharge of the debentures held by the taxpayer constituted a "retirement" thereof within the meaning of Section 117 (f) of the Revenue Act of 1934 so that the difference between their cost and the amount realized upon their discharge constituted a capital loss subject to the limitations of Section 117 (d) of the Act.

STATUTE INVOLVED

The pertinent provisions of the statute involved are printed in the Appendix, *infra*, pp. 9–11.

STATEMENT

The facts were stipulated (R. 23–68), and are summarized in the opinion of the Board of Tax Appeals (R. 10–15).

In May 1927 the taxpayer purchased debentures of New York United Hotels, Inc., maturing Feb-

ruary 1, 1947, having a total face value of $25,000, for which he paid $24,750. The obligations were subject to redemption at a premium at any time after 30 days notice. (R. 10, 23–24.)

In 1931 the debtor corporation encountered financial difficulties and the debenture holders consented to a plan of readjustment whereby, on certain conditions, they waived the payment of a portion of the interest payable on the debentures. (R. 10–11, 24, 28–29.)[1]

On December 15, 1933, ancillary receivers were appointed by the United States District Court for the Southern District of New York, at which time a plan to reorganize the debtor corporation was submitted to the court. The plan contemplated a sale of the assets of the corporation to a new corporation and permitted the debenture holders to purchase for cash, at par plus accrued interest, debentures to be issued by the new corporation having a face value equal to 1/100 of the face value of the old debentures. (R. 11, 24, 34–35, 40.) Upon purchase of the new debentures and surrender of the old debentures, the debenture holder was also entitled to receive with each $10 face value of new debentures, 5 shares of preferred stock of the new company and a voting trust certificate for 5 shares of common stock of the new company.[2] (R.

[1] The corporation had debentures of $5,113,500 outstanding. (R. 27.) Holders of debentures in the amount of $4,551,500 consented to this plan of readjustment. (R. 30.)

[2] Debenture holders who did not purchase the new debentures were to receive a voting trust certificate for 2½ shares of common stock of the new company. (R. 40.)

11, 24, 34–35, 40.) A supplemental plan (R. 44–46) was submitted to the court in February, 1934, making minor changes in the original plan (R. 11, 24).

On March 8, 1934, the court entered an order (R. 47–55) approving the plan, though there was no provision thereunder for debenture holders who did not participate in the plan of reorganization. (R. 11, 24, 40, 42.)

On May 22, 1934, the court entered its final order (R. 58–62) in the reorganization proceedings under which the receivers were directed, *inter alia,* to pay to debenture holders who would surrender their debentures with all coupons attached before a fixed time, $5 for each $1,000 face amount. (R. 11, 24–25.)[3]

Pursuant to the order of the court the taxpayer received a written notice which stated that the debtor corporation's assets had been sold and that he was entitled to receive $5 for each $1,000 face amount of his debentures upon surrendering them, with all interest coupons attached, on or before

[3] This statement is taken from the Board's findings and the stipulation. The court order, however, discloses that the receivers were directed to pay over certain funds to the debtor's landlord on the condition that it agree to pay over to the new company amounts sufficient to pay the debenture holders. (R. 61–62, 66.) The receivers were then discharged and the new corporation accepted the surrender of the debentures and paid the debenture holders. (R. 66–67.) This new corporation was the Roosevelt Hotel, Inc. (R. 49–50, 66–67.)

August 20, 1934. (R. 11, 25, 66–67.) This payment was stated to be "in full payment and settlement of said Debentures." (R. 11, 25, 67.) The taxpayer surrendered his debentures (for which he had paid $24,750) on June 22, 1934, and received $125 in cash for them. (R. 11, 25.)

The taxpayer attempted to deduct the difference between the cost of his debentures ($24,750) and the amount he received from the trustee in final settlement ($125) in his 1934 return as a bad debt. The Commissioner of Internal Revenue ruled that the transaction was governed by Section 117 (f) of the Revenue Act of 1934, and treated the amount in controversy as a capital loss subject to the limitations imposed by Section 117 (d) of the Act. (R. 6–7, 10, 23.) The Board of Tax Appeals sustained that determination (R. 10–16), but the Circuit Court of Appeals reversed (R. 72–73).

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that the transaction shown by the record did not constitute a retirement within the meaning of Section 117 (f) of the Revenue Act of 1934 of the debenture bonds held by the taxpayer.

2. In failing and refusing to hold that the loss resulting from the surrender and discharge of the debenture bonds held by the taxpayer constituted a capital loss subject to the limitations imposed by Section 117 (d) of the Revenue Act of 1934.

3. In holding that the loss resulting from the surrender and discharge of the debenture bonds held by the taxpayer constituted a bad debt deductible in full from the gross income.

4. In reversing the decision of the Board of Tax Appeals.

REASONS FOR GRANTING THE WRIT

1. The provisions in Section 117 (f) were first enacted in the Revenue Act of 1934; they are provisions of considerable importance and are frequently applied. The doubt which the decision below casts upon their meaning threatens to disrupt the orderly administrative application of the statute to concrete situations, and it is therefore a matter of general importance to obtain an authoritative decision as to the scope of Section 117 (f).

The confusion produced by the decision below is accentuated by the fact that it is in substantial conflict with *McClain* v. *Commissioner* (C. C. A. 5th), decided March 23, 1940 (not yet officially reported but published in Vol. 4, Prentice Hall, 1940, par. 62,518), affirming an unreported memorandum opinion of the Board of Tax Appeals which, in turn, was based upon its decision in this very case. In the *McClain* case the taxpayer, in 1918, acquired Water Improvement District bonds of Cameron County, Texas, which had a then value and cost basis to him of $15,000. The District was unable to pay the principal and interest on these bonds in

1935. It unsuccessfully sought municipal bankruptcy, then applied to the Reconstruction Finance Corporation for a loan. The loan was granted in an amount sufficient to pay $0.499 per dollar on its bonds upon condition that a sufficient amount of the bonds be deposited and committed to the plan of refinancing required by the Reconstruction Finance Corporation. The taxpayer, with other bondholders, deposited his Water Improvement District bonds in accordance with that condition, the refinancing plan was carried out, and he received $7,476.75 in 1935 in full settlement and cancellation of his bonds. He attempted to deduct the difference between that amount and his cost basis as a bad debt in his 1935 return. The Commissioner of Internal Revenue ruled that the taxpayer's Water Improvement District bonds had been retired within the meaning of Section 117 (f) of the Revenue Act of 1934, *infra,* and that the loss deduction was subject to the limitations of Section 117 (d). The Board of Tax Appeals and the Circuit Court of Appeals sustained that determination.

The question in the *McClain* case, as well as in the present case, was whether payment and discharge of the obligation in question constituted "retirement" within the meaning of Section 117 (f). Although it is possible to spell out differentiating features in the facts of the two cases, we believe that they are broadly in conflict with each other, and in any event are productive of such un-

certainty with respect to the correct interpretation of Section 117 (f) as to call for further review by this Court.

2. A petition for a writ of certiorari has been filed in *Helvering* v. *Hammel,* No. 895, present Term, involving a cognate question under Section 117 (d). Although the issues are not identical, they are sufficiently similar to justify considering them together. Accordingly, if certiorari be granted in the *Hammel* case, it should likewise be granted here in order that the Court may have a more complete presentation of the general problem.

CONCLUSION

Wherefore, it is respectfully submitted that this petition should be granted.

FRANCIS BIDDLE,
Solicitor General.

APRIL 1940.

APPENDIX

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(j) *Capital Losses.*—Losses from sales or exchanges of capital assets shall be allowed only to the extent provided in section 117 (d).

(k) *Bad Debts.*—Debts ascertained to be worthless and charged off within the taxable year (or, in the discretion of the Commissioner, a reasonable addition to a reserve for bad debts); and when satisfied that a debt is recoverable only in part, the Commissioner may allow such debt, in an amount not in excess of the part charged off within the taxable year, as a deduction.

* * * * *

[U. S. C., Title 26, Sec. 23.]

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *General Rule.*—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net income:

100 per centum if the capital asset has been held for not more than 1 year;

80 per centum if the capital asset has been held for more than 1 year but not for more than 2 years;

60 per centum if the capital asset has been held for more than 2 years but not for more than 5 years;

40 per centum if the capital asset has been held for more than 5 years but not for more than 10 years;

30 per centum if the capital asset has been held for more than 10 years.

(b) *Definition of Capital Assets.*—For the purposes of this title, "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.

* * * * *

(d) *Limitation on Capital Losses.*—Losses from sales or exchanges of capital assets shall be allowed only to the extent of $2,000 plus the gains from such sales or exchanges. If a bank or trust company incorporated under the laws of the United States or of any State or Territory, a substantial part of whose business is the receipt of deposits, sells any bond, debenture, note, or certificate or other evidence of indebtedness issued by any corporation (including one issued by a government or political subdivision thereof), with interest coupons or in registered form, any loss resulting from such sale (except such portion of the loss as does not exceed the amount, if any, by which the adjusted basis of such instrument exceeds the par or face value thereof) shall not be subject to the foregoing limitation and shall not be

included in determining the applicability of such limitation to other losses.

* * * * *

(f) *Retirement of Bonds, Etc.*—For the purposes of this title, amounts received by the holder upon the retirement of bonds, debentures, notes, or certificates or other evidences of indebtedness issued by any corporation (including those issued by a government or political subdivision thereof), with interest coupons or in registered form, shall be considered as amounts received in exchange therefor. [U. S. C., Title 26, Sec. 101.]

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